Appendix A

Audit Committee

23 September 2016

Report of: Interim Service Director – Finance & Section 151 Officer

Report Title: Treasury Management Quarter 1 Report 2016/17

Ward: Citywide

Officer presenting report: Annabel Scholes

Contact telephone number: 0117 92 22419

RECOMMENDATION

1. That Audit Committee note the report.

Purpose of the report:

2. The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly. This report provides a quarterly update for the Council's Treasury Management function to the end of June 2016.

   There are no policy changes to the strategy, the details in this report update the current Treasury position.

Current Strategy

3. The 2016–2019 Treasury Strategy identified a medium term borrowing requirement of £150m (£75m 2016/17, £75m 2017/18) to support the existing and future Capital Programme with the additional debt servicing costs met from revenue savings from capital investment and the economic development fund.

   In addition the Council's agreed policy is to defer borrowing while it has significant levels of cash balances (£136m at June 2016), £75m estimated for March 2017. This strategy is prudent as investment returns are low and counterparty risk is relatively high. However, due to the significant change in the financial markets and fall in interest rates due to the referendum long term borrowing rates are at historic low levels and borrowing will be considered if rates are expected to rise significantly from their current position. This action will reduce the authority's exposure to interest rate risk.

Analysis of Debt and Investments

4. A summary of the Council's debt and Investment position as at 30th June 2016 (including a forecast to 31st March 2017) is shown in the table below:

Debt & Investments	31st March 2016		30th June 2016		31st March 2017	
	£m	Rate%	£m	Rate%	£m	Rate%
Long Term Debt - PWLB	292	5.09	292	5.09	292	5.09
Long Term Debt – Market	123	4.14	123	4.14	123	4.14
Short Term Borrowing	2	0.55	-	-	-	-
Total Debt	**417**	**4.81**	**415**	**4.81**	**415**	**4.81**
Investment	146	0.63	136	0.60	75	0.60
Net Borrowing Position	**271**		**279**		**340**	

No external borrowing included in the above table

Interest Rate Forecast and Economic Background

The Council's treasury advisor has provided the following forecast:

	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.50%	0.50%	0.50%
5yr PWLB rate	1.00%	1.10%	1.10%	1.10%	1.10%	1.10%	1.10%	1.20%	1.20%	1.20%	1.30%	1.30%
10yr PWLB rate	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.70%	1.80%	1.80%	1.80%	1.80%	1.90%
25yr PWLB rate	2.40%	2.40%	2.40%	2.50%	2.50%	2.50%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%
50yr PWLB rate	2.20%	2.20%	2.20%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%

5. After strong UK growth rates in 2013 (2.2%) and 2014 (2.9%), this slowed to 1.8% for 2015, though it still remained one of the leading rates among the G7 countries. The growth for quarter 1 is +0.4%.

   The Bank of England May Inflation Report included a forecast for growth for 2016 of 2.0% and 2.3% for 2017 on the assumption that the referendum result was a vote to remain. Following the result of the referendum it is generally agreed that this outcome will result in a slowing in growth in the second half of 2016, and therefore the bank of England have already indicated that the Monetary Policy Committee (MPC), would be likely to cut Bank Rate and will consider doing further quantitative easing in order to support growth.

   This latest forecast indicates Bank Rate will be cut by 0.25%, during the second quarter, and could be cut further to 0% or 0.10%. Thereafter, it is not anticipated for bank rate to change in 2016 or 2017 as the expected pace of recovery to be weak during a period of great uncertainty as to the final agreement between the UK and the EU on arrangements after Brexit. The Bank of England may also consider renewing a programme of quantitative easing; the prospect has already resulted in 10 year gilt yields falling below 1% for the first time ever. Bank Rate is not expected to start rising until quarter 2 2018 and for further increases to be at a slower pace

than before. The Governor of the Bank of England, Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual once they start due to the concerns about the impact of increases on many heavily indebted consumers, especially when the growth in average disposable income is still weak.

Annual Investment Strategy

6. Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 30th June 2016.

   Investment rates available in the market were broadly stable during the first half of the quarter but then took a slight downward path in the second half concluding with a significant drop after the referendum on a sharp rise in expectations of an imminent cut in Bank Rate and lower for longer expectations thereafter.

   The average level of funds available for investment purposes during the quarter was £175m. The return for period was 0.60% compared to the recognised benchmark of 0.36% (7 day Libid).

Icelandic Debt

7. Glitnir (£5m) – The administrator paid out 100% of the claim in 2012, 84% of the principal being received by the Council whilst the remainder (in Icelandic Kroner-ISK) was being held in an escrow account with a high credit quality Scandinavian bank. The Council were unable to repatriate these funds due to foreign exchange restrictions being imposed by the Icelandic authorities under Icelandic law. The authority has recently through its advisors successfully sold the sums held in the escrow account in an auction on the 16th of June 2016 held by the Central bank of Iceland resulting in the recovery of the investment with Glitnir.

Borrowing

8. Local authorities determine their own programmes for capital investment that are central to the delivery of quality public services. The authority is required by regulation to have regard to the Prudential Code to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable.

   The authority will consider proposals for capital investment to be funded by long term borrowing if the scheme can demonstrate -

   - positive income streams to meet the debt servicing costs, or
   - have identified alternative revenue savings to meet the debt servicing costs.

   As mentioned in paragraph 3, long term borrowing will be considered during the remainder of the year due to long term interest rates falling to historic low levels following the result of the referendum. Interest rates will continue to be monitored and if rates are expected to rise significantly the authority will borrow in accordance with the Treasury Strategy to reduce the authority's exposure to interest rate risk as the authority has a large future borrowing requirement.

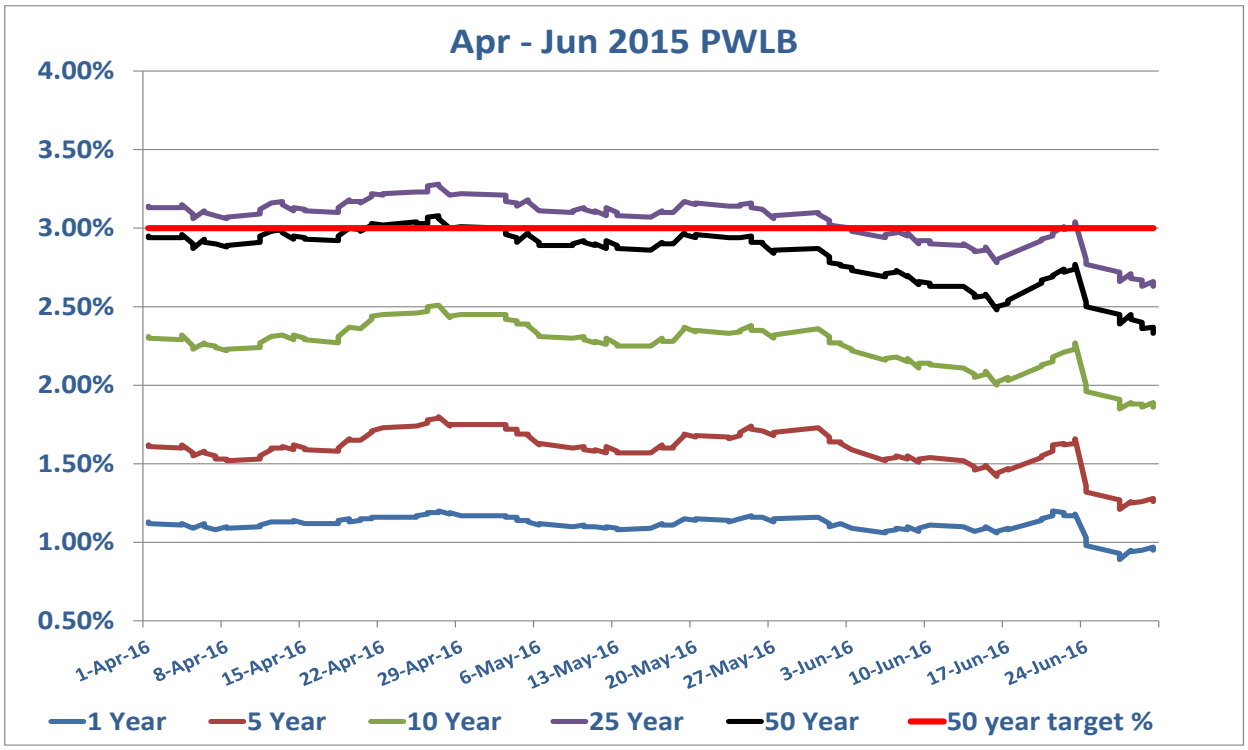
A key Prudential Code indicator is the Council's borrowing need (the Capital Financing Requirement also known as the CFR) the amount of external borrowing needed to support the existing capital programme. The CFR is a measure of the Council's underlying borrowing need, essentially capital expenditure planned to be funded by long term borrowing commonly known as Prudential Borrowing. The CFR over the medium term is £710m including the borrowing required for capital projects on the Capital Programme (tier1), primarily the Arena and Metrobus. Long term borrowing is currently £415m, therefore the Council have a borrowing need of £295m over the medium term. This is partially being met temporarily by using the authorities own internal cash resources (as at 31st March 2016 - £213m), such as reserves, working capital until they are needed for their purpose, commonly known as internal borrowing.

As set out in the graph(s) below, there has been significant volatility in PWLB rates during quarter 1 especially towards the run up to the referendum and with rates falling significantly after the referendum in anticipation that there is likely to be further quantitative easing in the coming months.

During the quarter ended 30 June 2016, the 50 year PWLB (certainty) rate for new long term borrowing was 2.33% and is currently at 2.08% (6th July 2016) .

PWLB certainty rates quarter ended 30 June 2016

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.89%	1.21%	1.85%	2.63%	2.33%
Date	27/6/16	27/6/16	27/6/16	29/6/16	30/6/16
High	1.20%	1.80%	2.51%	3.28%	3.08%
Date	27/4/16	27/4/16	27/4/16	27/4/16	27/4/16
Average	1.11%	1.59%	2.25%	3.05%	2.83%



Risk Assessment

9. Borrowing and lending activity is reported.

   The principal risks associated with treasury management are:

   - The risk of loss as a result of failure of counterparties.

   - This is mitigated by limiting the types of investment instruments used, setting lending criteria for counterparties, and limiting the extent of exposure to individual counterparties;

   The risk of loss as a result of borrowing at high rates of interest/lending at low rates of interest.

   This is mitigated by planning and undertaking borrowing and lending in the light of advisers' assessments of future interest rate movements, and by undertaking most long term borrowing at fixed rates of interest (to reduce the volatility of capital financing costs).

Public sector equality duties:

10. There are no proposals in this report, which require either a statement as to the relevance of public sector equality duties or an Equalities Impact Assessment.

Environmental checklist / eco impact assessment

11. Not applicable

Legal and Resource Implications

Legal

12. The Council is under a duty to manage its resources prudently and therefore due consideration must always be given to its borrowing and lending strategy. A wide range of local authority financial activities, including borrowing, lending, financial management, and the approval of types of investment vehicle are governed by legislation and various regulations. The Council is obliged to comply with these.

    Legal advice provided by Shahzia Daya

Financial

(a) Revenue

13. The financing costs arising from planned borrowing are provided for in the revenue budget and medium term financial plan. Any additional operating costs will have to be contained within the revenue budget of the relevant department.

    Advice given by Jon Clayton

(b) Capital

14. None Sought

Land

15. None.

Personnel

16. None.

Appendices: None

Access to Information (Background Papers): None